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SUBJECT: Brazil: Explaining the PAC (the Growth Acceleration Program)

REF: Brasilia 36

11. (SBU) INTRODUCTION AND SUMMARY: The Growth Acceleration Program (PAC), a principal initiative of President Lula's second mandate, marked its one-year anniversary on January 22. Its stated objective is to increase Brazil's low level of investment spending (about 17-18 percent of GDP in 2007 compared to 28 percent in India and more than 40 percent in China) that many people believe is partly responsible for Brazil's low rate of growth relative to many other emerging market countries. The PAC is actually aimed at catalyzing private and parastatal investment. About 85% of the "PAC" program is intended to come from PAC-incentivized private and parastatal investment. While actual private sector disbursement figures under the PAC are not publicly available, the private sector does not appear so far to be heavily engaged in PAC projects and no federal government public-private partnership has yet been approved despite the 1994 law enabling PPPs. Execution of PAC projects is cumbersome, assumes private investment that may not come forward easily given contracting, regulatory and other challenges, and suffers from a dearth of project planning and execution expertise that has dwindled over the last thirty years within the Brazilian bureaucracy. For the PAC to succeed, Brazil needs to address these structural problems affecting the investment climate and the challenges associated with lack of technical expertise (reftel).  
END INTRODUCTION AND SUMMARY.

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WHAT IS THE PAC?  
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12. (U) The Growth Acceleration Program (PAC) is technically a set of administrative measures aimed at fostering private investment with leveraged public budget resources. Launched in January 2007, it currently comprises 27 pieces of legislation, out of which 18 have already been transformed into law. Significant examples include Law 11477/07, which creates the Infrastructure Investment Fund, as well as Law 11491/07, which creates the Investment Fund based on resources from the Labor Time Savings Fund (FGTS). Four other bills have been approved by either the Senate or the Chamber of Deputies only and 5 are not yet approved by either chamber. Amongst the nine legislative proposals still pending final approval are the bill that proposes changes to the government procurement law, measures to clarify regulatory agencies' responsibilities, and anti-trust legislation. The Executive also issued 9 Decrees related to the PAC in the taxation, social security and Federal management fields.

13. (U) According to the GOB, the package of legislation covers "credit incentives" such as establishing the FGTS Investment Fund; "investment climate improvements" including the 2004 proposed law to clarify inter-relationships and division of responsibilities between

regulatory agencies or the 2005 proposed anti-trust law; "tax exemptions" totaling R\$ 6.65 billion in 2007 and R\$ 11.5 billion in 2008, which include exemptions on purchases of project-related capital goods and on infrastructure investment funds; "fiscal consistency," meaning the 2005 law raising government spending limits; and "long term fiscal measures," including a bill that proposes changes to the Brazilian bidding process, which has already been approved by the Chamber and still needs to be approved by the Senate, and a bill that set up limits for payroll expenditures, which awaits a vote in the Chamber of Deputies.

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HOW BIG IS THE PAC AND WHERE DOES THE MONEY COME FROM?  
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14. (U) The program was originally designed to invest R\$ 503.9 billion (or US\$ 280 billion) from both public and private funds, for the period 2007-2010. R\$ 67.8 billion (US\$ 37.8 billion) is projected to come from the federal budget (R\$16.6bn for 2007) and the remaining part, R\$ 436.1 billion (US\$ 242.3 billion) is envisaged to come from the private sector and parastatal companies (e.g. Petrobras and Eletrobras). The break down of the program's estimated hoped-for endowment by its three major areas is shown in the following table:

(R\$ billion)

	Federal Budget	Parastatals/Private Sector	Total
Logistics	33.0	25.3	58.3
Energy	-	274.8	274.8
Social Infrastructure	34.8	136.0	170.8

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Total	67.8	436.1	503.9
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As of end-2007, the federal budget had allocated R\$ 16.6 billion to the PAC, of which R\$ 16.0 billion was actually committed toward projects. Of that R\$ 16 bn, R\$ 4.5 billion (of the \$16bn) has been disbursed, short of the program's ambitious goals. In other words, GOB has so far spent R\$ 4.5 bn toward an intended R\$503.9 bn program. Although R\$ 436.1 of the R\$ 503.9 is supposed to come from the private sector, little clarity exists regarding how much private investment has actually come forward.

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PAC PROJECT PLANNING AND EXECUTION CYCLE  
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15. (U) PAC projects follow a cycle of five steps: 1) "National Planning," such as the National Plan of Logistics and Transportation and the 10-year Energy Plan; 2) "Study," involving environmental studies and the General Technical Description, e.g. Federal road BR-242 - Mato Grosso state; 3) "Project," involving the environmental licensing and the bidding processes, e.g., Guarulhos airport passenger terminal; 4) "Works," involving the construction itself, which additionally requires an "installation" license, e.g. Tucurui dam enclosure, Belo Horizonte, Recife, Salvador and Fortaleza metro systems; and 5) "Operation," (ie, the project is actually up and running) e.g. parts of the North-South railroad and the Santos Dumont airport (refurbishment and expansion completed); an operation license is required at that stage.

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PROGRESS IN PAC "AXES" - LOGISTICS, ENERGY, AND SOCIAL AND URBAN  
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17. (SBU) The GOB divides PAC projects into three conceptual baskets, or "axes" - logistics, energy, and social and urban projects. As of end-December 2007, GOB is monitoring 2,126 individual projects in these three major "axes" (1,312 logistics projects, 602 energy projects, and 212 social and urban projects). GOB "monitoring" includes three possible classifications for a given project: as of September, "green light" (projects that are on schedule and

disruptions are not expected) correspond to 86% of the current public works; "yellow light" (prospective projects that are on schedule but include potential disruption risks) are estimated as equaling 12% of the total; and "red light" (due to either schedule delays or high execution risks or both) accounts for 2% of the total projects planned. "Risks" could be, for example, difficulties in obtaining environmental licensing, an investigation by the Federal Accounting Court on the financial execution of a given work, a rejected property indemnization for a road, a discovery of an archeological site in a road/railroad planned route, and other problems. (NOTE: Because these government ratings are in fact somewhat subjective, they may be more optimistic than a close examination of individual project progress would warrant. END NOTE).

Overall, about 60% of planned projects are underway in some fashion, while the other 40% are still in their initial phases of the cycle, i.e., bidding process or waiting for environmental licensing. Some examples of public works recently announced are the Madeira river power plant Jirau, whose auction has been scheduled for May 9, 2008; seven groups of roads concessions (five won by Spanish bidders and two by Brazilians in October 2007, over 2000 km of roads for 25 years); other sections of the North-South railroad; and petroleum maritime platforms.

#### Logistics Infrastructure Axis

18. (U) In this category, the GOB monitors works in roads, railroads, ports, dams, hydro ways, merchant marine and airports. This axis will also include the brand new National Port Dredging Program (8 works) and 6 airport refurbishment works. According to the PAC documentation, estimated total investment in logistics 2007-2010 will amount to R\$ 58.3 billion, where it is expected R\$ 33 billion would come from federal public funds, and R\$ 17 billion from BNDES financing lines. Highways and other roads are projected to absorb over 60% of the total.

#### Energy Infrastructure Axis

19. (U) This group consists of: hydroelectric power plants, targeting power generation of nearly 17,000 MW by 2017; thermal power plants, targeting 88 MW; nuclear power plant (Angra 3), targeting 1,350 MW; survey of 16,000 MW in the Tapajss (Amazonas/Par states) and Juruena (Amazonas/Mato Grosso states) basins; transmission lines targeting a total of 8,108 km; oil exploration (marine platforms) targeting 1.09 million more barrels

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per day; and gas ducts targeting a total of 2,661 km. The estimated projected investment totals 274.8 million in the 2007-2010 period. There are no federal monies in this category; however, Petrobras and Eletrobras are expected to play a major role in project investment. Oil and Gas are expected to absorb nearly two thirds of total investment in this category, and renewable fuels only 6.5%. The GOB also expects an additional R\$ 189.2 billion private sector investment after 2010.

#### Social and Urban Infrastructure Axis

110. (U) This third category includes projects in sanitation and habitation; underground systems (subway); environmental conservation; water supply and sewage treatment; and land irrigation. Total estimated projected social and urban investment is R\$ 170.8 billion for 2007-2010, with habitation and sanitation together accounting for 86% of this amount. Federal funds, not including the program "Light for All," are expected to add up to R\$ 34 billion, and BNDES financing lines are expected to cover R\$ 65.5 billion.

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COMMENT  
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111. (SBU) At the one-year anniversary mark, progress on actual project execution has been slow under the PAC. Some major difficulties identified by observers include bureaucracy, for example, in the process of granting tax exemptions on capital goods, as well as regulatory framework problems, e.g. delays in obtaining environmental licenses. Another factor some cite is supply-demand

imbalances in leasing/buying needed capital equipment such as cranes, heavy trucks, back-hoe loaders and tractors, where delivery delays can be up to two years. A parallel problem is the scarcity of experts qualified in planning and executing these projects. GOB budget constraints may also eventually impact the PAC as well, although this remains to be seen. Evaluation over the course of 2008 will show more clearly whether the PAC is able to get off the ground successfully, but much will depend on GOB addressing underlying challenges affecting the attractiveness of Brazil as a destination for private sector investment. In 2008, Election Law 9,504, dated 9/30/1997, may further constrain progress to some extent under the PAC. This law prohibits any new voluntary transfer of public funds to states/municipalities in the three months before an election (municipal elections are scheduled for October 2008). However, disbursements under existing contracts are permitted. END COMMENT

¶12. (U) NOTE: GOB issued a project update publication on January 22, 2008 to mark the one-year anniversary of the PAC. This document is also available on-line at <http://www.planalto.gov.br/pac/> in Portuguese only. For the convenience of Washington users, translated details of illustrative projects from the GOB publication have been e-mailed to Treasury, State, Commerce and TDA desk officers. GOB intends to release PAC updates every four months through PAC's envisioned 2010 end date. END NOTE

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